What is Soft Paternalism, and the Best it has to Offer in the Battle to Quit Smoking

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Abstract. The behavioral law and economics concept of "soft paternalism" offers a way to satisfy both the American predilection to remain skeptical of paternalistic government regulation and the temptation to take advantage of well-established evidence that people often stray from the traditional assumption of rational behavior and decision-making in fairly predictable ways, by offering policymakers the possibility of crafting regulations and laws aimed towards steering people away from irrational, or boundedly rational, behavior so long as individuals can easily opt-out if they so choose. Of all the proposals introduced and outlined by various academics in the field of behavioral law and economics, a government-sponsored self-regulation regime using customizable cigarette ID cards offers the best of what soft paternalism has to offer. The plan

is directed towards an activity that is universally accepted as a "bad" and that imposes great costs upon both society and the individual smokers. Smoking offers an example of when behavior and decisions stray from the rational actor model, as smokers display prominent symptoms of self-control and time-inconsistency problems, leading them to make choices that stray from their *own* personal assessment of what is in their best interest. Moreover, an ID card regime takes advantage of soft paternalism tools that have previously been shown to be highly effective in mitigating boundedly rational behavior, including consciously selected default rules and individually selected pre-commitments. Finally, an ID card system includes the lynchpin of soft-paternalism, libertarian-pleasing opt-outs, by allowing time-consistent smokers who are not smoking due to self-control problems to opt-out of any regulation, allowing them to maximize their own rationally derived personal welfare with minimal inconvenience.

Introduction

"Paternalism" is generally not a popular word in the United States. We are the nation of the "American Dream," of taking responsibility for one's own life and running with it, of, pulling oneself up by the bootstraps. Americans are famous for distrusting their own government, especially of the federal sort, and demanding to decide things for themselves locally, at least when absolutely zero government involvement is not an option. In short, Americans don't like the suits in Washington telling them what to do or how to do it.

While our French and German friends may chuckle and wonder why we have stubbornly refused to follow their lead and conjure up our very own splendid dreams of a government supported utopia, many, if not most, traditional economists and economics-driven policy makers would seem likely to applaud our American love for independence and pejorative use of the word "paternalism". Even when markets fail or people make poor choices (i.e. engaging in drugs, smoking, excessive drinking, etc.), these traditionalist shun away from anything labeled as paternalistic, favoring instead minimalist measures, such as correcting imperfect information by providing the public with a public service announcement, or no measures at all (arguing that people are the best sources of information regarding their own well-being and preferences; therefore, the choices people make, even unseemly ones, are the most welfare enhancing).

This paper seeks to challenge this absolutist stance against paternalism both generally and specifically in the case of government regulation of tobacco, largely by drawing attention to and bringing together the work academics in the field of behavioral law and economics. I will argue that a soft form of paternalism is both desirable and often inevitable in any sort of organized society, that the insights of behavioral law and economics into the potential benefits of a soft paternalism approach can benefit regulators and policymakers across a myriad of fields, and that novel (softly paternalistic) proposals in the troublesome realm of government regulation of cigarettes are worthy of and ripe for serious consideration.

The remainder of this paper will proceed as follows. Section 1 provides an introduction to the notion of soft paternalism, continues with justifications for consideration by policymakers of a soft paternalism approach to law and regulation, and then addresses criticisms of this approach. Section 2 lays out a brief history of government and FDA regulation of tobacco. Section 3 introduces concepts of behavioral law and economics particularly relevant to tobacco regulation: self-control and "time-inconsistency" problems, and, finally, Section 4 will discuss and judge several novel soft paternalism approaches to the problem of smoking (which implicates both self-control and time-inconsistency problems), including sin taxes and cigarette ID cards, that merit genuine consideration by future regulators.

Section 1:

Soft Paternalism

Rejection of Traditional Assumptions (Homo Economicus)

The behavioral law and economics idea of soft paternalism requires as its foundation a rejection of an assumption that is wildly pervasive and influential in the fields of both economics and the law: "that almost all people, almost all of the time, make choices that are in their best interest or at the very least are better, by their own lights, than the choices that would be made by third parties."[1] Another way of phrasing this assumption, in regards to law and economics, is, "'All human behavior can be viewed as involving participants who [1] maximize their utility [2] from a stable set of preferences and [3] accumulate an optimal amount of information and other inputs in a variety of markets.' The task of law and economics is to determine the implications of such rational maximizing behavior in and out of markets, and its legal implications for markets and other institutions."[2]

Proponents of behavioral law and economics, however, take exception to the whole-hearted acceptance of this assumption. According to Christine Jolls, et al, behavioral law and economics, the theoretical mother of soft paternalism, is the exploration of, "...the implications of actual (not hypothesized) human behavior for the law. How do 'real people' differ from homo economicus?"[3]

[1]Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), p. 1163.

[2]Jolls, Christine, Sunstein, Cass R., and Richard Thaler, "A Behavioral Approach to Law and Economics," *Stanford Law Review,* 50 Stan. L. Rev. 1471 (May 1998), p. 1476. Citing Becker, Gary S., *The Economic Approach to Human Behavior,* (1976), p. 14.

[3]Jolls, Christine, Sunstein, Cass R., and Richard Thaler, "A Behavioral Approach to Law and Economics," *Stanford Law Review,* 50 Stan. L. Rev. 1471 (May 1998), p. 1476.

The dominant answer to the question posed by Jolls, et al, is that humans are not perfect economic actors. Rather, people are limited by "bounded rationality." "Bounded rationality…refers to the obvious fact that human cognitive abilities are not infinite. We have limited computational skills and seriously flawed memories. People can respond sensibly to these failings; thus it might be said that people sometimes respond rationality to their own cognitive limitations, minimizing the sum of decision costs and error costs. To deal with limited memories we make lists. To deal with limited brain power and time we use mental shortcuts and rules of thumb. But even with these remedies, and in some cases because of these remedies, human behavior differs in systematic ways from that predicted by the standard economic model of unbounded rationality. Even when the use of mental shortcuts is rational, it can produce predictable mistakes. The departures from the standard model can be divided into two categories: judgment and decisionmaking. Actual judgments show systematic departures from models of unbiased forecasts, and actual decisions often violate the axioms of expected utility theory." [4]

Judgments

In the category of judgments, the work of Tversky and Kahneman[5] is seminal. According to Tversky and Kahneman, "Many decisions are based on beliefs concerning the likelihood of uncertain events such as the outcome of an election, the guilt of a defendant, or the future value of the dollar. These beliefs are

[4] *Id.* Citing, Simon, Herbert A., "A Behavioral Model of Rational Choice," *The Quarterly Journal of Economics,* 69 Q.J. Econ. 99, (1955).

[5] Tvesrky, Amos & Daniel Kahneman, "Judgment under Uncertainty: Heuristics and Biases," *Science*, New Series, Vol. 185, No. 4157, (Sep. 27, 1974).

usually expressed in statements such as 'I think that. . . ,' 'chances are. . . ,' 'it is unlikely that. . . ' and so forth. . . [P]eople rely on a limited number of heuristic principles[6] which reduce the complex tasks of assessing probabilities and predicting values to simpler judgmental operations. In general, these heuristics are quite useful, but sometimes they lead to severe and systematic errors."[7] The authors go on to introduce the three heuristics they conclude are most systemic in people's perceptions: "representativeness," "availability" and "anchoring."

Representativeness

The representativeness heuristic can account for situations in which, ". . . probabilities are evaluated by the degree to which. . . A resembles B. For example, when A is highly representative of B, the probability that A originates from B is judged to be high. . . if A is not similar to B, the probability that A originates from B is judged to be low."[8] Serious errors in making judgments using the representativeness heuristic can occur, for instance, because actors often mistakenly exhibit an, ". . . insensitivity to prior probability of outcomes."[9] In one cited example, subjects were told that the group from which "descriptions had been drawn consisted of 70 engineers and 30 lawyers. . . Apparently, subjects evaluated the likelihood that a particular description belonged to an engineer rather than to a lawyer by the degree to which this description was representative of the two stereotypes, with little or no regard for the prior probabilities of the categories."

[6] Often called "rules of thumb."

[7] Tvesrky, Amos & Daniel Kahneman, "Judgment under Uncertainty: Heuristics and Biases," *Science*, New Series, Vol. 185, No. 4157, (Sep. 27, 1974).

[8] *Id.*

[9] For further discussion, see *Id.*

Availability

The availability heuristic is at play in situations where "people assess the frequency of a class or probability of an event by the ease with which instances or occurrences can be brought to mind. . . However, availability is affected by factors other than frequency and probability. Consequently, the reliance on availability leads to predictable biases. . . " such as, ". . . the retrievability of instances."[10]

In addition to the obvious example of familiarity (where, for instance, ". . . one may assess the risk of heart attack. . . by recalling such occurrences among one's acquaintances. . . "), "there are other factors, such as salience, which affect. . . retrievability. For example, the impact of seeing a house burning on the subjective probability of such accidents is probably greater than the impact of reading about a fire in the local paper."[11]

In one study that exemplifies the salience aspect of the availability heuristic, participants were read a list of celebrities, both male and female. The participants were than asked to determine whether the list read to them consisted of more males or more females. Of course, different groups were read lists comprised of different names, and some of the lists contained more famous men and others a greater number of famous women. Not surprisingly, for each list, the participants incorrectly determined that the gender with more famous names appeared on the list more than the opposite gender[12].

Anchoring

Finally, the anchoring heuristic is summed up as a phenomenon where, ". . . people make estimates by starting from an initial value that is adjusted to yield the final answer. The initial value, or starting point, may be

[10] Tvesrky, Amos & Daniel Kahneman, "Judgment under Uncertainty: Heuristics and Biases," *Science*, New Series, Vol. 185, No. 4157, (Sep. 27, 1974).

[11] *Id.*

[12] *Id.*

suggested by the formulation of the problem, or it may be the result of a partial computation...different starting points yield different estimates, which are biased toward the initial value." For example, in one study, participants were asked to estimate a variety of quantities, including the percentage of African countries in the United Nations. Before the participants were allowed to estimate, a "wheel of fortune," consisting of numbers ranging from 0 to 100, was spun and a number thereby determined in the presence of the participants. The participants had already been split into different groups, with each group receiving a different "wheel of fortune" number. Participants were than asked to select whether the percentage of African nations in the U.N. was higher or lower than the determined number, and then to estimate the actual percentage. The "wheel of fortune" numbers were shown to have a clear effect on estimates. As shown in Figure 1 below, "...the median estimates of the percentage of African countries in the United Nations were 25 and 45 for groups that received 10 and 65, respectively, as starting points."[13]

Fig 1. Estimated Percentage of African Nations in UN by Initial Value

Optimism Bias

Another oft-cited example of the effect of biases upon the ability of people to make proper judgments in the classical economics sense is referred to as the "optimism bias," or "risk denial." In short, people often come up with different estimates when they rate a given risk to themselves, their families, their country, the world, or people in general.[14]

[13] *Id.*

[14] Sjoberg, Lennart, "Factors in Risk Perception," *Risk Analysis*, Vol. 20, No.1, (2000). *See also,* Hermand, Daniele, Karsenty, Serge, Py, Yves, Guillet, Laruent, Chauvin, Bruno, Simeone, Arnaud, Sastre Maria T. M., and Etienne Mullet, "Risk Target: An Interactive Context Factor in Risk Perception," *Risk Analysis,* Vol. 23, No. 4, (2003).

Separate studies by Lennart Sjoberg and Hermand, et al, suggest that “drastic differences” exist in the way people perceive risks to themselves (or their families) and. . . people in general.[15] Moreover, people will often rank the order between risks differently for different “targets.”[16]

Figure 1 below, created from findings of the Hermand, et al, study, suggest that, “people most often claim to be less subjected to risk than others. . . ”[17] Of course, these findings support the existence of an optimism bias, as everyone cannot be correct in their belief that they are less exposed to risk than the general public, even if some are.

Fig. 2.[18] Average Risk ratings for a Sampling of Items for which Target Effect was Strongest

The notion of a personal optimism bias is further buttressed by the findings that when people are simply asked to rate a risk, without specification of a target, this “no-target” condition produces risks ratings roughly equal to those found when rating “general risk,”[19]*andthat,“...ratingtherisktoʻanyoneperson′gavethesameresult,refutingthesometimes−heardexpla*

What is most important to glean, for purposes of the remainder of this paper, from the notion of these

[15] *Id.*
[16] Sjoberg, Lennart, “Factors in Risk Perception,” *Risk Analysis*, Vol. 20, No.1, (2000).
[17] *Id.*
[18] In the Hermand, et al, study, in the personal condition, “participants were informed that the term ‘risk’ referred to the risk of being personally seriously ill (wounded, and even of dying). . . In the. . . country condition. . . participants were informed that the term ‘risk’ referred to the risk for all people in the country of being seriously ill. In the . . . world condition. . . participants were informed that the term ‘risk’ referred to the risk for all people in the whole world of being seriously ill, wounded, or dying. . . Responses were given on a 11-point scale label from ‘No risk’ to ‘Extremely severe risk. . . ’ the marks on the scale ranged from 0 to 100.”
[19] Sjoberg, Lennart, “Factors in Risk Perception,” *Risk Analysis*, Vol. 20, No.1, (2000).

[20] *Id.*

and other boundedly rational mistakes in judgments is that the behavior stemming from these heuristics ("shortcuts") and biases is often highly predictable.

Decisionmaking

In regards to the rationality of choices (decisionmaking), Sunstein and Thaler take a fairly aggressive stance, with which the author of this paper agrees. According to Sunstein and Thaler[21]:

[21] Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), pp. 1167-1170.

> The presumption that individual choices should be respected is usually based on the claim that people do an excellent job of making choices, or at least that they do a far better job than third parties could possibly do. As far as we can tell, there is little empirical support for this claim, at least if it is offered in this general form. Consider the issue of obesity. Rates of obesity in the United States are now approaching 20 percent, and over 60 percent of Americans are considered either obese or overweight. There is overwhelming evidence that obesity causes serious health risks, frequently leading to premature death. It is quite fantastic to suggest that everyone is choosing the optimal diet, or a diet that is preferable to what might be produced with third-party guidance. Of course, rational people care about the taste of food, not simply about health, and we do not claim that everyone who is overweight is necessarily failing to act rationally. It is the strong claim that all or almost all Americans are choosing their diet optimally that we reject as untenable. What is true for diets is true as well for much other risk-related behavior, including smoking and drinking, which produce over 500,000 premature deaths each year. In these circumstances, people's choices cannot reasonably be thought, in all domains, to be the best means of promoting their well-being. Indeed, many smokers, drinkers, and overeaters are willing to pay for third parties to help them choose better consumption sets. On a more scientific level, research by psychologists and economists over the past three decades has raised questions about the rationality of many judgments and decisions that individuals make. People fail to make forecasts that are consistent with Bayes's rule[22], use heuristics that can lead them to make systematic blunders, exhibit preference reversals (that is, they prefer A to B and B to A), suffer from problems of self-control, and make different choices depending on the framing of the problem. It is possible to raise questions about some of these findings and to think that people may do a better job of choosing in the real world than they do in the laboratory. But studies of actual choices reveal many of the same problems, even when the stakes are high.

Sunstein and Thaler go on to support this position by citing a revealing behavioral economics study involving defined contribution savings plan portfolios[23]. Employees were shown the probability distributions of expected retirement income from their own and two other (reflecting the average and median choices of their fellow employees) investment portfolios (the participants were not told which portfolio was their own).

In line with the rejection of the "homo economicus" assumption, only twenty percent of the participants viewed their own portfolios as advantageous over both the others. On average, the participants preferred the median portfolio to their own by a significant margin and rated the average portfolio equally with their own.[24] As Sunstein and Thaler put it: "Apparently, people do not gain much, by their own lights, from choosing investment portfolios from themselves."[25]

Moreover, Tversky and Kahneman's "prospect theory" is increasingly gaining traction as an alternative to traditional economics' expected utility theory. Prospect theory posits that people will value an outcome according to the difference it presents from an initial starting point, rather than the actual value of the outcome it self. For instance, "...discovering that one will receive a bonus of $2500 is often experienced differently if the previous year's bonus was $0 than if the previous year's bonus was $5000, wholly apart from any tangible financial obligations the individual faces."[26]

Paternalism, Everywhere

[23]Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), p. 1169. *Citing,* Bernatzi, Shlomo and Richard H. Thaler, "How Much is Investor Autonomy Worth?" *Journal of Finance,* 57 J Fin 1593, (2002).

[24]*Id.*

[25]Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), 1169

[26]Jolls, Christine and Cass Sunstein, "Debiasing through Law," University of Chicago, John M. Olin Law & Economics Working Paper No. 225, (2005).

Default Rules

One of the keys to understanding the normative value of policies employing soft paternalism is that, given the failure of the "perfectly rational economic actor" paradigm, paternalism is already an unavoidable force in nearly all facets of civilized existence: "In many situations, some organization or agent must make a choice that will affect the behavior of some other people. There is, in those situations, no alternative to a kind of paternalism—at least in the form of an intervention that affects what people choose. We are emphasizing, then, the possibility that people's preferences, in certain domains and across a certain range, are influenced by the choices made by planners. . . 'A minimum of state intervention is always necessary. . . When a loss is left where it falls in an auto accident, it is not because God so ordained it. Rather it is because the state has granted the injurer an entitlement to be free of liability and will intervene to prevent the victim's friends, if they are stronger, from taking compensation from the injurer."'[27] The point here is that governments and other authorities (i.e., employers), through the creation of default rules such as the entitlement to the injurer just described, already inevitability affect and drive choices, preferences and behavior, even when parties can opt-out (i.e., by contracting around a default rule).

A default rule effect upon choices and behavior has been shown to be quite prominent and powerful in a plethora of settings. For instance:

[27] *Id*, pp. 1174-1175. *Citing* Korobkin, Russell, "The Status Quo Bias and Contract Default Rules," *Cornell Law Review,* Cornell L Rev 608, 675, (1998); Sunstein, Cass R., "Endogenous Preferences, Environmental Law, *Journal of Legislative Studies,* 22 J Leg Stud 217, 224, (1993); Ellickson, Robert C., "Order without Law: How Neighbors Settle Disputes," (Harvard 1991); Calabresi, Guido and A. Douglas Melamed, "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral," *Harvard Law Review*, 85 Harv L Rev 1089, (1972), pp. 1090-91.

> In the context of insurance, an unplanned, natural experiment showed that the default rule can be very sticky. New Jersey created a system in which the default insurance program for motorists included a relatively low premium and no right to sue; purchasers were allowed to deviate from the default program and to purchase the right to sue by choosing a program with that right and also a higher premium. By contrast, Pennsylvania offered a default program containing a full right to sue and a relatively high premium; purchasers could elect to switch to a new plan by selling the more ample right to sue and paying a lower premium. In both cases, the default rule tended to stick. A strong majority accepted the default rule in both states, with only about 20 percent of New Jersey drivers acquiring the full right to sue, and 75 percent of Pennsylvanians retaining that right. There is no reason to think that the citizens of Pennsylvania have systematically different preferences from the citizens of New Jersey. The default plan is what produced the ultimate effects. Indeed, controlled experiments find the same results, showing that the value of the right to sue is much higher when it is presented as part of the default package.[28]

A deeper examination of a recent study by James J. Choi, et al[29], involving the pervasive effect of default rules upon the behavior and decisions of employees in large organizations in regards to defined contribution pension plans (401(k) savings plans) is worthwhile to underscore the impact of default rules

The heart of the Choi, et al study (and of central importance to understanding the concept of unavoidable paternalism) involves an examination of the effect of changing the organizational default rules in regards to defined contribution pension plans and reveals what the authors dub, "the path of least resistance," effect, whereby employees overwhelming select the default plan, regardless of their stated preferences[30]. To begin, the most common 401(k) plans begin with a default rule of non-participation and require the employee to

[29]Choi, James J., Laibson, David, Madrian Brigitte C., and Andrew Metrick, "Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance," in Poterba, James M., *16 Tax Policy and the Economy 67,* (MIT 2002).

[30]*Id.*

take the affirmative step of enrolling in a plan[31]. These plans usually lead to savings behavior that is below ideal levels. Here, Choi, et al, examined the results of a previous survey[32] that followed the experience of three companies who switched the default rule for employees from non-participation to automatic enrollment. Two of the companies switched to automatic enrollment for new employees only, while the third later also switched the default for non-enrolled holdover employees as well.

The results of the study are quite telling. For all three companies, Choi, et al, first examined the rates of participation in company 401(k) plans for employees who began their jobs before the default rule switch to 401(k) automatic enrollment. The ranges of these figures are represented in Figure 3, below.

Fig. 3. Ranges of Rates of Participation in 401(k) Plans with Non-Participation Default[33]

While true that the rate of 401(k) participation increased under the non-participation default rule over time, Choi, et al, found that there was still a significant jump in participation rates after a default rule switch to automatic enrollment. The increase in the range of 401(k) participation rates after 6 months of employment under the new automatic enrollment default rule relative to the non-participation default are shown in Figure 4 below.

Fig. 4 Range of 401(k) Participation Rates After 6 months of Hire by Default Rule[34]

[31] *Id.*

[32] *Id.* Citing, Choi, James, Laibson, David, Madrian, Brigitte and Andrew Metrick, "For Better or for Worse: Default Effects and 401(k) Savings Behavior," University of Chicago Working Paper, (2001).

[33] *Id.* Actual ranges were 26%-43% six months after hire, 50%-62% after two years and 65-69% after three years.

[34] *Id.* Actual range of employee participation in company 401(k) plans after six months under the new default of automatic enrollment was 86-96 percent.

As the increases in 401(k) participation rates over time under the old default rule should indicate, it is true that the marginal effect of the new automatic enrollment default rule decreases with time. However, according to Choi, et al, the rate of employee participation in company 401(k) plans is still a substantial 31 to 34 percent higher after three years under the new default of automatic enrollment[35].

One initial survey finding of particular import to the implications of default rules, soft paternalism and the Choi, et al, study in the realm of tobacco regulation involves the future plans of the study participants. While describing the survey findings here, the important implications of this particular facet of the survey will be discussed in more detail later in this paper.

In short, the Choi, et al, study began with a survey of employee savings. The survey revealed that over two-thirds of the participants were saving at a rate lower than what participants labeled as an ideal savings rate[36]. Most of the remaining one-third labeled their savings rate as "about right," while an, unsurprisingly, low number (one-half of one percent) rated their savings as above their ideal rate[37].

Fig. 5 Perceived Adequacy of Retirement Savings Relative to Ideal Rate

Moreover, none of the Choi, et al, survey respondents stated a future intention of saving at a rate below their current rate, while 35 percent of those in the low savers group of respondents and 11 percent of those in the "about right" group reported plans to increase contribution rates in the closely following months[38]. A

[35] *Id.*

[36] *Id.*

[37] Choi, et al, were initially concerned that individual perceptions of savings behavior would not correlate well with the participants actual savings. However, upon comparison with actual administrative records, the authors revealed that people reporting their savings rate as below the optimal rate indeed saved at rates lower than those who labeled their savings rate as "about right." In the group of self-perceived overly-low savers average pre-tax contributions were 5.8% of income. In the group of "about right" savers, that rate was 9.0% of income.

[38] Choi, James J., Laibson, David, Madrian Brigitte C., and Andrew Metrick, "Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance," in Poterba, James M., *16 Tax Policy and the Economy 67,* (MIT 2002). (Most respondents planning to increase savings rates stated an intention to do so within one month, while another 23

follow-up survey, however, revealed that an overwhelming percentage (86 percent) of those planning a near term increase to savings rates did not follow through with their stated intentions during the four months following the initial survey[39].

Fig. 6.

As previously stated, these findings have potentially significant implications for the potential of soft paternalism as a method of regulating tobacco use and will be discussed in more detail below.

What is the fallout of the Choi, et al, study? The authors summarize their conclusions as drawing attention to, "the importance of passive decision-making. For better or worse, many households appear to passively accept the status quo." More important is the presence of a, "common theme: employees often take the path of least resistance. As a result employers cannot escape this responsibility. Whatever savings plan an employer creates necessarily advantages certain passive or nearly passive choices over other active choices. Sophisticated employers should choose their plan defaults carefully, since these defaults will strongly influence the retirement preparation of their employees."[40]

Choi, et al, also generalize the implications of their work, by stressing the role of defaults in policy making generally: "Policy-makers should also recognize the role of defaults, since policy-makers can facilitate, with

percent planned to do so within two months).

[39] *Id.*

[40] Choi, James J., Laibson, David, Madrian Brigitte C., and Andrew Metrick, "Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance," in Poterba, James M., *16 Tax Policy and the Economy 67,* (MIT 2002).

laws and regulations, the socially optimal use of defaults. For example, default contributions to company stock may lead to insufficient diversification. Policymakers could legally cap default investments to such problematic asset categories... It is easy to identify dozens of ways that thoughtful regulations can influence passive decision-makers without encroaching on the freedom of active decision-makers to opt out of the defaults and choose in their own (perceived) best interest."[41]

Indeed, if one were to ascribe to the view, expressed above, that a no-liability regime (in the context of auto accidents) is inevitably and unavoidably already a legal (default rule) regime (the granting of a legal entitlement to an injurer) in and of itself – one that inevitably and unavoidably affects choices, preferences and behavior – it seems virtually impossible to conjure up a scenario in any organized civilization where paternalism (or some sort and on some level, at least) is not already in play.

Anchoring (Again)

While default rules often seem to maintain a certain level of primacy in the discussion of unavoidable (or "inevitable") paternalism, they are not alone in substantiating the unavoidable paternalism view. As noted above, the anchoring heuristic is as a phenomenon whereby, "... people make estimates by starting from an initial value that is adjusted to yield the final answer. The initial value, or starting, may be suggested by the formulation of the problem, or it may be the result of a partial computation... different starting points yield different estimates, which are biased toward the initial values."

Anchoring has been shown to have a perverse effect upon the ability of policymakers to create accurate

[41] *Id.*

and effective regulations by skewing the results of contingent valuation studies (increasingly employed in the process of crafting regulation, i.e. increased safety), which attempt to elicit (not to affect) people's values, such as "willingness to pay." The problem lies in the anchoring heuristic. Participants (ordinary people) in contingent valuation studies usually lack well-formed preferences and values (at least in the quantitative sense) for the measures they are being asked to state. Participants' statements of values are thereby too easily influenced by how the surveys are presented.

According to Sunstein and Thaler, "Paternalism, in the sense of effects on preferences and choices, is not supposed to be a part of the picture. But it is extremely difficult for contingent valuation studies to avoid constructing the very values that they are supposed to discover…some form of paternalism verges on the inevitable: Stated values will often be affected…by how the questions are set up."[42]

An example of the anchoring heuristic effect in this context involves the willingness to pay for a reduction in motor vehicle related deaths[43]. Each participant was faced with both a pound (money) amount and a figure representing reduction of risk. Half of the participants were shown an initial money amount of 25 pounds, while the remainder was shown an initial money amount of 75 pounds. They were then asked if they would or would not pay the given amount for the given reduction of risk figure. If they agreed to pay, the money amount would rise until they stated an unwillingness to pay (there was also a "not sure" option; if they were "not sure" money amounts were adjusted until a stable response could be elicited).

The results revealed a sizeable anchoring effect. For each given figure representing risk, the *minimum* willingness to pay was higher for the 75 pound group than the *maximum* willingness to pay for the 25 pound group[44] (see Figure 7, below).

[42] Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), p. 1177.

[43] *Id.* Citing Jones-Lee, Michael, and Graham Loomes, "Private Values and Public Policy," in *Conflict and Tradeoffs in Decision Making*, (Cambridge 2001), pp. 205, 208-212.

[44] *Id.*

Fig. 7 Willingness to Pay by Initial Dollar Value For Reduction in Risk

Accordingly, it seems a sensible conclusion to state that, "...people are sometimes uncertain about appropriate values, and whenever they are, anchors have an effect—sometimes a startlingly large one...What is clear is that in the domains in which contingent valuation studies are used, people often lack well-formed preferences, and starting points have important consequences for behavior and choice."[45]

Framing

A concept related to the anchoring heuristic, the so-called "framing" effect, will often operate paternalistically in a manner similar to anchoring. Framing has been commonly cited to show that the decisions, preferences and behavior of people who, "...lack clear, stable, or well-ordered preferences," can be drastically manipulated by the wording of identical alternatives[46].

In one experiment, participants' willingness to undergo a given medical procedure varied drastically depending up an alteration of the wording of the question, notwithstanding the fact that the two versions communicated identical information. Two groups of participants were provided with the following information:

1) "'Of those who undergo this procedure, 90 percent are still alive after five years."'

[45] Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), p. 1178.

[46] Sunstein, Cass and Richard H. Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, Fall 2003, 70 U. Chi. L. Rev. 1159, pp. 1161, 1179-1180.

2) "'Of those who undergo this procedure, 10 percent are dead after five years."'

Tellingly, participants who were told version one were far more likely to agree to the medical procedure than those who were told version two.[47]

Moreover, "People weigh losses more heavily than gains... They will typically bet on a coin toss only if their potential winnings are twice as big as the amount they stand to lose. Likewise, mothers will go to greater lengths to avoid the harm a lack of breastmilk might inflict than to secure the benefits breastfeeding can bring."[48]

It seems clear then, that in certain cases of ill-formed preferences, stated preferences, behavior and choices can often be little more than, "an artifact of how the question is put."[49] As in the medical procedure experiment, this seemingly simple effect can have life-altering consequences. In short, "How information is framed matters."[50]

How Default Rules, Framing and Anchoring Work

Academics in the field of behavioral law and economics have offered numerous explanations for how default rules, framing effects and the anchoring heuristics operate to influence behavior, choices and preferences. One plausible explanation is that people, "might think that the default plan or value captures one or the

[47] *Id.* Citing, Redelmeier, Donald A., Rozin, Paul and Daniel Kahneman, "Understanding Patients' Decisions: Cognitive and Emotional Perspectives," *Journal of the American Medical Association*, (1993), 270 JAMA 72, 73.

[48] "The Avuncular State," *Economist*, (Apr. 6, 2006), pp. 67, 67-69; citing Benartzi, Shlomo and Richard Thaler, "Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving," *Journal of Political Economy,* No.1, 2004.

[49] *Id.*

[50] *Id.*

other."[51] In other words, it is conceivable that an individual might initially hold a slight preference for one option over another, but a default rule may lead the individual to believe that planners decided upon the default as the result of an accurate deliberative process over the individual's wellbeing.

Another possibility involves inertia. Overriding a default rule or initial value requires at least some minimal level of action, such as holding onto, filling out and returning a form. This can, "leave room for failures due to memory lapses, sloth, and procrastination."[52]

Academics have also put forth so-called "endowment effects" as an explanation for the persistence of defaults, framing and anchoring. The term "endowment effect" represents the phenomenon whereby people usually assign higher values to goods that they already have or received, relative to those goods that are assigned to others[53]. Choices made are then affected by these values, which have been skewed according to what individuals perceive has been allocated to them.

Finally, many academics, including Sunstein and Thaler emphasis the role played by "ill-formed preferences" in these effects. Often, options can be hard to understand, leading people to be confused as to their best option, making it more tempting to fall back on a default. Or even when options are well understood, choices may still be difficult to value. Imagine, for instance, choosing between a stable investment with a given return and a riskier investment with a sizably higher return. Moreover, the more unfamiliar the context of a decision is, the less likely that preferences will be easily formed[54].

[51] Sunstein, Cass and Richard H. Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, Fall 2003, 70 U. Chi. L. Rev. 1159, pp. 1161, 1180.
[52] *Id.*
[53] *Id.*
[54] *Id.*

Finally, What is Soft Paternalism and Why?

We are faced then, with the following situation: 1) We are well aware that there are bounds to the rationality of human beings, and as a result mistakes are often made in the judging and decision-making processes; moreover, these errors in judgment and decision making are often highly predictable; and 2) Authorities, such as policymakers, employers and regulators, already inevitably effect and skew behavior, choices and preferences through, for instance, default rules (even in cases of no rule), anchoring and framing – thus, paternalism, on some level, is unavoidable.

The most productive and responsible use of this growing behavioral law and economics knowledge, therefore, is to harness and use it to create laws, default rules, and information campaigns, "with the explicit goal of improving welfare of the people affected by them."[55]

Proponents of behavioral law and economics acknowledge that to traditional libertarians and economist, this point may seem objectionable. Paternalism, as the term is used in the behavioral law and economics movement and this paper, mean policymakers, both private and public, "not trying to track people's anticipated choices," but rather, "self-consciously attempting to move people in welfare-promoting directions."[56] Therefore, it is true that such a shift in the fundamental motives behind policymaking would constitute paternalism.

However, Sunstein and Thaler seek to soothe the concerns of these hard-core libertarians by arguing convincingly that soft paternalism (or "libertarian paternalism" as they call it) can successfully combine self-

[55] *Id.*
[56] *Id.*

conscious attempts to harness knowledge about people's actual behavior to create welfare promoting policies with libertarianism: "The libertarian aspect of our strategies lies in the straightforward insistence that, in general, people should be free to opt out of specified arrangements if they choose to do so. To borrow a phrase, libertarian paternalists urge that people should be 'free to choose.' Hence we do not aim to defend any approach that blocks individual choices."[57]

Thus, soft paternalism seeks to take advantage of knowledge gained from the field of behavioral economics and other social sciences (such as psychology) to alter individuals' decisions that would be different if they, "...had complete information, unlimited cognitive abilities and no lack of selfcontrol,"[58] while remaining cautious to libertarian sentiments by only imposing, "trivial costs on those who seek to depart from the planner's preferred option."[59]

The Choi, et al, study serves as a case in point. If it is well-established that the welfare of individuals and society generally are improved by an increased rate of employee enrollment in defined contribution company pension plans, it seems difficult to justify an opposition to switching the default rule from non-participation to automatic enrollment (which as discussed above, has dramatic positive effects upon enrollment) so long as employees are given a relatively easy path towards opting out.

Indeed, as discussed throughout this paper thus far, a default rule of non-participation already unavoidably affects and skews behavior. Therefore, it is far from clear that an automatic enrollment default is any more paternalistic in the sense of affecting behavior, choices and preferences. Moreover, those libertarians who fear government coercion when soft paternalism is employed in the public sector should be similarly assuaged by the presence of easy opt-outs in any true soft paternalism scheme.

[57] *Id.* Citing, Friedman, Milton, and Rose Friedman, *Free to Choose: A Personal Statement*, Harcourt Brace Jovanovich, (1980).

[58] *Id.*

[59] *Id.*

In the context of the public sector, Christine Jolls and Cass Sunstein provide an useful perspective from which to judge the merits of a behavioral law and economics approach to creating law. The heart of their position lies in the distinction between "debiasing law" and "debiasing through law."[60]

Both debiasing law and debiasing through the law share the goal of dealing effectively with human departures from the traditional economics assumption of a perfectly rational "homo economicus." Both approaches also share the position of this paper that, "given a demonstration of the existence and importance of a particular aspect of bounded rationality, the law should be structured to presume the existence of that particular shortcoming in human behavior."[61]

Debiasing law is then a method of "insulation" from irrational behavior, an attempt "to protect legal outcomes from falling victim to bounded rationality."[62] According to Jolls and Sunstein, most attempts to deal with bounded rationality through law fits within this "insulation" characterization. For example, the growing acceptance of the position that boundedly rational individuals believe, "that potentially risky products are substantially safer than they in fact are," has led to the adoption of, "heightened standards of manufacturer liability for consumer products."[63] Moreover, corporate law's business judgment rule can be thought of as insulation from, "'Monday morning quarterbacking,' from judges and juries," whose decisions would hold corporations, directors and officers liable, "for bad events even if preventing those events would have been

[60]Jolls, Christine and Cass Sunstein, "Debiasing through Law," John M. Olin Law & Economics Working Paper No. 225, 2D Series, The Law School of The University of Chicago, (2005).
[61]*Id.*
[62]*Id.*
[63]*Id,* Citing, Hanson, Jon D., and Douglas A. Kysar, "Taking Behavioralism Seriously: Some Evidence of Market Manipulation," *Harvard Law Review,* 112 Harv L Rev 1420, (1999).

extremely difficult,"[64] or even when the decision was the correct one when it was made (likely in a situation involving considerable uncertainty).

On the other hand, debiasing through law is born from the belief that, "legal policy may respond best to problems of bounded rationality not by insulating legal outcomes from its effects, but instead by operating directly on the boundedly rational behavior and attempting to help people either to reduce or to eliminate it."[65] Such debiasing through law, "will often be a less intrusive, more direct, and more democratic response to the problem of bounded rationality."[66] Moreover, debiasing through law represents the approach taken by soft paternalism – that of, "self-consciously attempting to move people in welfare-promoting directions."[67]

A useful example of the Jolls and Sunstein approach of debiasing through law involves debiasing in response to the optimism bias (discussed above) effect manifested in the context of consumer safety. As mentioned earlier, it is well established that "optimism bias is likely to produce an overall underestimation by consumers of the risk associated by consumers of the risk associated with a product."[68] It is worth nothing that Jolls and Sunstein acknowledge that evidence of optimism bias in the realm of consumer safety may also justify consideration of a debiasing law approach of legal insulation through, for instance, heightened standards of product liability or a complete ban of the product.[69] However, as the authors point out, a heightened standard of product liability or product ban would, "impose large costs,"[70] such as reducing use of an useful product to below optimal levels for those who accurately assess the risks associated with the product in the case of heightened standards, and a complete loss of welfare associated with the product's use in the case of an outright ban.

[64] *Id,* Citing, Rachlinski, Jeffrey, "The Uncertain Psychological Case for Paternalism. In Symposium: Empirical Legal Realism: A New Social Scientific Assessment of Law and Human Behavior," *Northwestern University Law Review,* 97:1165-1225 (2003).

[65] Jolls, Christine and Cass Sunstein, "Debiasing through Law," John M. Olin Law & Economics Working Paper No. 225, 2D Series, The Law School of The University of Chicago, (2005).

[66] *Id.*

[67] *Id.*

[68] *Id.*

[69] *Id.*

[70] *Id.*

Jolls and Sunstein begin by describing evidence that optimism bias can be successfully controlled by, "harnessing separate aspects of boundedly rational behavior."[71] One of the potential aspects of boundedly rational behavior at the disposal of policymakers to aid overly optimistic consumers is the availability heuristic (described above). The availability heuristic has potential to temper optimism bias because, "making an occurrence 'available' increases individuals' estimates of the likelihood of the occurrence."[72] The other potential strategy cited by Jolls and Sunstein involves debiasing through framing, combined with an understanding of loss aversion: "...the social science evidence shows that many people weigh losses more heavily than gains in evaluating potential outcomes. This evidence suggests that framing the presentation of information to exploit the extra weight attached to losses may counteract bounded rationality in the form of optimism bias."[73] For instance, conveying the losses associated with neglecting breast self-examination (missing a then-treatable tumor) has been shown to be far more effective in changing behavior than emphasizing positive aspects of self-examination (increased chance of finding a tumor).[74]

In terms of translating these debiasing techniques into law, Jolls and Sunstein offer potential legal strategies for both debiasing through availability and debiasing through framing.

First, the authors note that, "debiasing through the availability heuristic would focus on putting at consumers' cognitive disposal the prospect of negative outcomes from use, or at least unsafe use, of a particular product," and suggest a legal regime whereby firms would have a legal obligation to, "provide a truthful account of consequences that resulted from a particular harm-producing use of the product, rather than simply providing a generalized warning that fails to harness availability...the law could further require that the real-life story of accident or injury be printed in large type and displayed prominently, so that consumers

[71] *Id.*
[72] *Id.*
[73] *Id.*
[74] *Id.* Citing, Meyerowitz, Beth E., and Shelly Chaiken, "The Effect of Message Framing on Breast Self-Examination: Attitudes, Intentions, and Behavior," *Journal of Personality and Social Psychology,* 52:500-510.

would be likely to see and read it before using the product."[75]

In regards to debiasing through framing, the authors note that, "Simple requirements that firms 'provide' information' may be ineffective in this context in part because firms' interest will be in framing the information in a way that minimizes the risks perceived by consumers."[76] Thus, the authors propose, "a legal requirement that firms identify the negative consequences associated with their product or a particular use of their product, rather than the positive consequences associated with an alternative product or with an alternative use of the product."[77]

It is worth repeating that these examples of potential implementations of debiasing through law, versus debiasing law, represents the approach taken by soft paternalism – that of "self-consciously attempting to move people in welfare-promoting directions."[78] Moreover, unlike debiasing law approaches such as heightened liability or a complete ban (leading to increased costs and/or product removal), neither debiasing through availability with a requirement upon firms to prominently display real life accounts nor debiasing through framing by requiring the display of negative consequences of a product's use violate the libertarian principle of ensuring choice by leaving fully intact the consumers' choice to use the product. Indeed, so long as consumers are properly steered clear of boundedly rational behavior, those rationally valuing the benefits of a product's use more heavily than the risk-related and other costs of use would continue to enhance their welfare (something planners should avoid eliminating) by using the product.

[75] *Id.* ("It bears nothing that an effort to use availability to counteract optimism bias would improve not only the decision making of consumers suffering from optimism bias but also that of consumers suffering from simple information failures. A conspicuous, prominent account of injury from a product may help to correct the estimated probability of harm attached to the product by an optimistically biased consumer. At the same time, it should improve the behavior of imperfectly informed but not necessarily biased consumers."

[76] *Id.*

[77] *Id.*

[78] *Id.*

Criticisms of Soft Paternalism

The embracement of behavioral law and economics and the soft paternalism approach, of course, is not free of critics, many of whom present legitimate and serious concerns.

To begin, in "Paternalism and Psychology," Harvard economist Edward L. Glaeser argues that soft paternalists fail to recognize and properly emphasize many of the dangers inherit in paternalism, both hard and soft, including when used to address boundedly rational behavior:[79] "[F]laws in human cognition should make us more, not less, wary about trusting government decisionmaking. The debate over paternalism must weight private and public errors. If errors are thought to be exogenous then there is little reason to believe that these errors will be greater among public or private decisionmakers, but if psychological errors are understood to be endogenous, then there are good reasons why we might think that public decisionmaking is likely to be more flawed than private decision making."[80]

Glaeser continues by supplying evidence that psychological errors are indeed endogenous, and then asserts that this organic origin of boundedly rational behavior weighs against public decision-making. First, Glaeser points out that private actors, "face stronger incentives to get things right than government decisionmakers do when making decisions about private individuals."[81]

Next, Glaeser presents a model that assumes (as is indeed likely often the case) that "the supply of error," or boundedly rational behavior, stems from a private firm whose interest lies in generating larger profits by manipulating various errors in individuals' decision making process, such as the framing effect, to increase

[79]Glaeser, Edward L., "Paternalism and Psychology," *The University of Chicago Law Review,* 73 U. Chi. L. Rev. 133, No. 1, (2006).
[80]*Id.*
[81]*Id.*

demand. This model then suggests that, "If the cost of persuading one government bureaucrat is less than the cost of persuading millions of consumers, then government bureaucrats will be more prone to error than private consumers."[82]

Moreover, according to Glaeser, individuals will naturally have greater incentives to make error-free judgments and decisions in the context of personal consumption choices than when electing public officials. Moreover, "the lack of incentives in politics and among politicians and the small number of decisionmakers suggest that government decisionmaking is likely to be particularly erroneous."[83] Therefore, allowing a small number of elected officials to make paternalistic decisions, thereby taking personal decisions out of the hands of better incentivized individuals, will only exacerbate a failed decision making process and lead to a potential "tyranny of the majority."[84]

There are undoubtedly other concerns as well. For instance, some would argue that in addition to the concerns outlined by Glaeser, such as paternalistic policymakers being similarly susceptible to bounded rationality and more likely to hold weaker incentives to make error-free judgments and decisions than an individual facing a personal decision, any move in the direction towards paternalism should be rejected due to the "public choice" problem. The public choice problem entails lawmakers and regulators who are less concerned with individual or societal well-being than their own parochial or individual interests. Therefore, according to these critics, placing more decisions into the hands of conflicted public officials would be a mistake.

Moreover, others argue that decisions should also be taken out of the hands of public officials because of legitimate concerns regarding the potential for regulatory capture. Capture theory, "states that either regu-

[82] *Id.*
[83] *Id.*
[84] *Id.*

lation is supplied in response to... industry's demand for regulation (in other words, legislators are captured by the industry) or the regulatory agency comes to be controlled by the industry over time (in other words, regulators are captured by the industry)[85]. Increased policymaker discretion to implement more paternalistic policies, accordingly, would simply lead to more manipulative regulation and legislation geared towards the interests of profit-maximizing firms rather than the well-being of individuals and society.

Another oft-heard criticism of soft paternalism is that it is inherently coercive, and therefore wrong as a matter of principle regardless of behavioral law and economics-based justifications.

Yet another criticism of soft paternalism heard from libertarian circles is that in many cases, such as the 401(k) defined contribution pension plans example, a choice need not necessarily be made between one default over another. The suggested alternative involves requiring active choice, whereby, "Employers could avoid choosing a default if they required employees to make an active choice, either in or out."[86] Also, rather than embracing paternalism, if employers must assign some default rules they should, "avoid paternalism by doing what most employees would want employers to do. On this approach, a default rule can successfully avoid paternalism if it tracks employees' preferences."[87] Moreover, some strong supporters of libertarians and many economists would argue that the proper response to individual errors in judgment and decision-making involves increased provision of information, so that individuals can make their own personal welfare maximizing decisions on a informed basis, rather than any paternalistic tactics to nudge individuals into policymakers' preferred directions.

Finally, on the other end of the spectrum lie those with the utmost faith in policymakers, ardent paternalists. These "anti-libertarians" are, "suspicious of freedom of choice and would prefer to embrace welfare

[85]Viscusi, Kip W., Harrington, Joseph E., Jr., and John M. Vernon, *Economics of Regulation and Antitrust,* 4th Ed., The MIT Press, (Cambridge 2005), pp. 379-380. Citing, Bernstein, Marver H., *Regulating Business by Independent Commission,* Princeton University Press, (Princeton 1955).

[86]Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), p. 1173.

[87]Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), p. 1174.

instead."[88] Therefore, those in this camp would likely ask soft paternalists why, if we know that one behavior produces more net welfare than another, opt outs are included at all.

Response to Criticisms

Sunstein and Thaler, as well as others, provide useful and largely convincing responses to the skeptics of the behavioral law and economics approach, and many of their defenses of soft paternalism incorporate concepts that have been discussed at length in this paper.

To begin, in response with those who distrust the government to make error-free or properly motivated decisions, most proponents of soft paternalism concede the point that policymakers, being human, are similarly susceptible to bounded rationality.[89] Policymakers are usually, however, in positions of great informational superiority relative to individuals. This informational advantage will help to temper policymakers' own bounded rationality and usually covers a wide range of issues, including which policies are welfare maximizing on a societal level, an awareness of the pitfalls of bounded rationality (so as to make them easier to avoid) and where and how consumers are making boundedly rational errors in judgment and decisionmaking.

Moreover, as discussed early, on many levels paternalism is simply unavoidable. According to Sunstein and Thaler, "In many situations, some organization or agent must make a choice that will affect the behavior of some other people. There is, in those situations, no alternative to a kind of paternalism –at least in the form of an intervention that affects what people choose... [G]overnments... have to provide starting points of one or another kid; this is not avoidable... they do so everyday through the rules of contract and tort, in

[88] *Id,* p. 1166.
[89] *Id.* P. 1165.

a way that inevitably affects some preferences and choices. In this respect, the anti-paternalist position is unhelpful—a literal nonstarter."[90] It therefore seems clear that as paternalism in government is inevitable, the best available option is to confront our policymakers and elected officials with an explicitly asserted expectation that the unavoidable paternalistic powers of government are to be used to move individual choices and behavior in productive and positive, rather than parochial or politically beneficial, directions.

Capture theory, as a criticism leveled towards soft paternalism, is on far from solid theoretical or empirical ground. According to Viscusi, et al, capture theory (CT), "has no theoretical underpinnings because it does not explain how regulation comes to be controlled by the industry. In light of there being several interest groups affected by regulation, including consumer and labor groups as well as firms, why should regulation be controlled by industry rather than by these other interest groups?"[91]

Moreover, a growing body of empirical evidence, inconsistent with the expectations of capture theory, has been surfacing. For instance, "... *cross subsidization* is when a multiproduct firm prices some goods below average cost and makes up for the losses through revenue collected from the sale of other goods priced above average cost. Such pricing behavior is inconsistent with profit maximization and thus cannot be considered pro-producer. Cross-subsidization has been regularly observed in such regulated industries as railroads, airlines, and intercity telecommunications. The other property is that regulation is often biased towards small producers. Small producers are allowed to earn greater profits relative to larger firms under regulation than they would have earned in an unregulated market... Perhaps the strongest evidence against CT is the long list of regulations that were not supported by industry and have resulted in lower profits. The list includes oil and natural gas price regulation and social regulation over the environment, product safety, and worker safety."[92]

[90] *Id.* Pp. 1164-1165.
[91] Viscusi, Kip W., Harrington, Joseph E., Jr., and John M. Vernon, *Economics of Regulation and Antitrust,* 4^{th} Ed., The MIT Press, (Cambridge 2005), pp. 379-380.
[92] *Id.*

As mentioned above, some critics of soft paternalism claim that any form of paternalism is inherently coercive and therefore objectionable. It seems difficult, however, to comprehend how a soft paternalism regime that simply, for instance, changes a default rule or presents information in a manner that utilizes (or combats) framing effects forces anyone to do anything, especially when considering that any desirable soft paternalism approach should include an easily exercisable override mechanism. This point is emphasized by the fact that the alternatives to changing the default – keeping the old default – or framing information – leaving information framed in the manner in which it is already inevitably framed – are equally paternalistic. Sunstein and Thaler highlight this point by asking whether, in response to evidence that people are increasingly likely to select an item the closer it is placed towards the front of a cafeteria line, would "anyone... object to putting the fruit and salad before the deserts at an... cafeteria if the results were to increase the consumption ratio of apples to Twinkies?"[93]

In regards to the suggestion that an active choice requirement should take precedence over planners choosing one default over another, Sunstein and Thaler properly recognize that active choice is another option that *planners* would be choosing and, "the very requirement that employees make a choice has a strong paternalistic element. Some employees may not want to have to make a choice (and might make a second-order choice not to have to do so)."[94]

Another alternative mentioned earlier involved planners simply tracking the preferences of individuals and then giving them what they want. While acknowledging that in some circumstances such a system may be a viable alternative, proponents of soft paternalism respond by citing evidence that in may areas, as numerous examples above (such as 401(k) enrollment behavior) reinforce, people simply lack well-formed preferences: "In such cases, it is meaningless to ask what most employees would do. The choices employees will make depend on the way the employer frames those choices. Employee 'preferences,' as such, do not exist in those

[93] Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), p. 1166.

[94] *Id.*

circumstances. We think that savings behavior is a good example of a domain in which preferences are likely to be ill-defined. Few households have either the knowledge or inclination to calculate their optimal life-cycle savings rate. . . ”[95]

In regards to the traditional economists' solution of choice – providing the public with information – there are numerous problems with such an approach. To begin with, any provision of information by the government is already inherently paternalistic – the way in which the government presents the information will inevitably affect individual behaviors, choices and preferences through framing effects. Thus, at the very least, the soft paternalism approach of attempting to understand and control framing effects to maximize individual and societal welfare when engaging in an information campaign should not be objectionable to the economist camp.

Moreover, it is worth noting the potential negative implications of “over-informing.” It has been shown that in the realm of information dissemination through hazard warnings, over-warning is a real concern. If information related to every danger or hazard is communicated to a consumer, then warnings begin to lose their effectiveness and sense of meaning to the consumer. In addition to this loss of information credibility (if everything is dangerous, nothing is dangerous) providing too much information runs the risk of distorting relative product comparisons[96]. In other words, if both Drano and Listerine are labeled as “dangerous” it becomes more difficult to alert consumers to the far more serious hazards involved with the use of Drano.

Finally, in response to hard-line paternalists' view that if planners know, “what's best,” choice should be taken out of individuals' hands, proponents of soft paternalism would argue that the freedom of choice associated with allowing for policy opt-outs and overrides actually enhances the ability of planners to win approval for policies that strive to maximize welfare by assuaging the concerns of the relatively dominant class of libertarians. Moreover, not all welfare-oriented policies are created equal, leading some to suggest

[95] *Id.*
[96] Viscusi, Kip, class lecture, “Economics and Regulation of Antitrust,” Harvard Law School (Fall 2005).

that, "the risks of confused or ill-motivated plans are reduced if people are given the opportunity to reject the planner's preferred solutions."[97] More importantly, opt-outs should help mitigate any damage caused when, inevitably, some well-intentioned policies turn out to be mistakes.

Section 2:

A Brief History of the Regulation of Cigarettes in the United States

Cigarettes are a "source of worldwide misery":[98] "Each year in the United States, approximately 440,000 persons die of a cigarette smoking-attributable illness, resulting in 5.6 million years of potential life lost, $75 billion in direct medical costs, and $82 billion in lost productivity... an estimated 8.6 million persons in the United States have serious illnesses attributed to smoking; chronic bronchitis and emphysema account for 59% of all smoking-attributable diseases."[99]

Highlights in the history of tobacco regulation in the United States include:

1)

[97] Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003), p. 1166

[98] Sumner, Walton II, "Permissive nicotine regulation as a complement to traditional tobacco control," Department of Medicine, Washington University School of Medicine, (St. Louis 2005).

[99] "Cigarette smoking-attributable morbidity—United States, 2000," Centers for Disease Control and Prevention, *MMWR Morb Mortal Wkly Rep,* 52:842-844 (2003).

The 1992 Synar Amendment, requiring States to establish and enforce prohibitions on the sale and distribution of tobacco products to persons under 18 years of age.[100]

2) The 1998 Master Settlement Agreement (MSA), prohibiting numerous marketing practices, especially those likely to entice youth; six corporate signatories also promised an endless series of payments to the settling States, currently $8 billion annually.[101]

3) The United States has endorsed the World Health Organizations' 2003 Framework Convention on Tobacco Control (FCTC).[102]

4) The FCTC enumerates well-studied, politically safe measures such as taxation; limiting youth access; regulating the content, packaging, advertising, and sales of tobacco products; and educating the public about risks.[103]

5) Several states and many municipalities now require smoke-free workplaces.[104]

Moreover, the 2004 Family Smoking Prevention and Tobacco Control Act (US Senate bill S2461), "would have given the US Food and Drug Administration [FDA] limited authority to regulate cigarettes to 'protect the public health."'[105] Although the measure was subsequently defeated in the House of Representatives, it is worthwhile to note some of the points of authority that the bill proposed to extend to the FDA:

1)

[101] *Id.*
[102] *Id.* Citing "WHO Framework Convention on Tobacco Control," `http://www.who.int/tobacco/framework/download/en/`
[103] *Id.*
[104] *Id.*
[105] *Id.*

Changing the language of the current cigarette health warnings, substantially enlarging their size and granting the FDA the authority to require new warnings in the future;

2) Full disclosure of ingredients added to tobacco products;

3) Authority for the FDA to regulate, or ban, terms such as “light” and “low tar”;

4) Authority for the FDA to mandate changes in the design of tobacco products to protect the public health, including authority to remove harmful ingredients and smoke constituents;

5) Authority for the FDA to do more to prevent minors from using tobacco products;

6) Authority to establish standards for products that could potentially reduce the harm caused by smoking and define the appropriate ways to communicate about these products; and

7) A ban on the sale of candy and fruit-flavored cigarettes.[106]

As many scholars have noted, the defeated legislation, as well as the regulatory measures noted above, are relatively weak; the FDA’s authority would be limited and specifically enumerated under the proposed bill and none of the previously implemented measure seem to have been particularly successful in substantially combating smoking related illnesses and death.

The need for more effective tools in the battle to realize effective and meaningful regulation of cigarettes is highlighted by the fact that, “most smokers would like to stop smoking cigarettes. Indeed, 40% of U.S. smokers have tried to quit smoking in the past 12 months, and 80% have tried to quite at some point.”[107]

[106] “Policies Practices & Positions: FDA Regulation of Tobacco Products,” Phillip Morris USA, `http://www.philipmorrisusa.com/en/policies_practices/legislation_regulation/fda_tobacco.asp`.

[107] Beshears, John, Choi, James, Laibson Davin, and Brigitte Madrian, “Early Decisions: A Regulatory Framework,” NBER working paper 11920, (2006). Citing, U.S. Department of Health and Human Services, “Health behaviors of adults: United States 1999-2001,” *Vital and Health Statistics,* (2004). Citing, Gruber, J. and B. Koszegi, “Tax incidence when individuals are time inconsistent: The case of cigarette excise taxes,” *Journal of Public Economics, 88,* (2004), pg. 1959-1987.

Traditional approaches (such as traditional economics), however, have thus far offered little insight into the enigma of smokers who would prefer to quit but continue smoking, and dying.

The dire need for more effective measures of government (FDA if future legislation is passed, or otherwise) regulation of tobacco having been established, this paper will now turn to recent developments in the field of behavioral law and economics that have offered new insights into tobacco products' grip upon users who want to quit, as well as innovative soft paternalism proposals aimed towards reversing the tide against cigarette related morbidity.

Section 3:
Self Control and Time Inconsistency Problems

We begin our exploration of how soft paternalism might benefit policymakers battling cigarette addiction by introducing further human deviations from the standard economics assumption of rational actors, or homo economicus, that are particularly applicable to the regulation of cigarettes: self control and time inconsistency problems.

A growing body of evidence suggests that, "People are impatient – they like to experience rewards soon and to delay costs until later. Economists almost always capture impatience by assuming that people discount streams of utility over time exponentially. Such preferences are *time-consistent:* A person's relative preference for well-being at an earlier date over a later date is the same no matter when she is asked." This traditional approach according to proponents of behavioral law and economics "ignores the human tendency to grab immediate rewards and to avoid immediate costs in a way that our 'long-run selves' do not appreciate."[108]

An example of this phenomenon is the oft-cited study where participants are asked to choose between seven hours of unpleasant activity on a given date, say, April 1 and eight hours of the same unpleasant activity two weeks later (April 15). If asked two months prior to the earlier date, nearly all participants select the earlier date. Time inconsistency is revealed when participants are asked again on April 1, and overwhelmingly choose to delay the unpleasant activity by two weeks, notwithstanding the extra hour of unpleasant activity that this entails.[109] Academics have termed this behavior, "present-biased preferences" ("When considering trade-offs between two future moments, present-biased preferences give stronger relative weight to the earlier moment as it gets closer."[110])

At this juncture, revisiting the problem of defined contribution pension plans explored above in the context of the Choi, et al, study should help to clarify the problems of self-control and time inconsistency, as well as to introduce an example of how soft paternalism can be successfully implemented to mitigate the boundedly rational behavior that is derivative of self-control and time inconsistency issues.

Recall from above that the Choi, et al, study revealed that about two-thirds of 401(k) participants perceive their savings rate to be "too low." Moreover, recall that 35 percent of those in the low savers group of respondents and 11 percent of those in the "about right" group reported future plans to increase contribution rates in the closely following months. Finally, recall that a follow-up survey revealed that an overwhelming

[108] O'Donoghue, Ted and Matthew Rabin, "Doing It Now or Later," *The American Economic Review,* Vol. 89, No. 1 (Mar. 1999), pp. 103-124.
[109] *Id.*
[110] *Id.*

percentage (86 percent) of those planning a near term increase to savings rates did not follow through with their stated intentions during the four months following the initial survey (see figure 6, above).

Other research has further revealed that, "employees at firms that offer only defined-contribution plans contribute little or nothing to the plan."[111] Furthermore, though automatic enrollment defaults, as shown above, "have proved to be remarkably successful in increasing enrollments... [t]he very inertia that explains why automatic enrollment increases participation rates can also lower the savings rates of those who do participate... the vast majority of new enrollees elected the default savings rate... and... analysis shows that many of these employees would have elected a higher savings rate if left to their own devices."[112]
Richard H. Thaler and Shlomo Bernatzi, are, however, unsurprised and largely attribute these findings to problems of self-control and procrastination, "the familiar tendency to postpone unpleasant tasks"[113] (loss aversion is also implicated as individuals overly-weight the decrease (loss) in take home pay after a contribution rate increase). People often procrastinate due to time inconsistency, "because they (wrongly) think that whatever they will be doing later will not be as important as what they are doing now."[114] Thaler and Bernatzi, therefore characterize low savings behavior as a mistake, in the sense that the low savers themselves, "might characterize the action in the same way, just as someone who is 100 pounds overweight might agree that he or she weighs too much."[115]

[111] *Id.*
[112] *Id.* Citing, Choi, James J., Laibson, David, Madrian, Brigitte, and Andrew Metrick. "For Better or for Worse: Default Effects and 401(k) Savings Behavior," in *Perspectives on the Economics of Aging*, University of Chicago Press, (Chicago); Madrian, Brigitte C., and Dennis Shea, "The Power of Suggestion: An Analysis of 401(k) Participation and Savings Behavior," Working Paper, Chicago: Univ. Chicago, Grad. School Bus., (1999).
[113] *Id.*
[114] *Id.*
[115] *Id.*

> Thaler and Bernatzi therefore proposed an innovative soft paternalism program, "to give workers the option of committing themselves now to increasing their savings rate later, each time they get a raise,"[116] to deal with the boundedly rational behavior exhibited in savings behavior as a result of self control and time inconsistency problems: Save More Tomorrow™ (SMarT). The four main pillars of the plan are: 1) approaching employees about increasing their contribution rates a considerable time before their scheduled pay increase; 2) contributions of participants are increased as soon as they receive a raise ("This feature mitigates the perceived loss aversion of a cut in take-home pay"); 3) contributions continue to increase with each additional raise until a preset maximum is hit; and 4) participants are allowed to opt out of the plan at any time.[117]

According to the findings of Thaler and Bernatzi, the SMarT program was an overwhelming success. Most offered employees elected to enroll and the vast majority of those who enrolled never exercised the opt-out. Moreover, the program's first implementation (the data from this implementation covers four annual raises) resulted in a nearly four-fold increase in savings rates.[118]

Thaler and Bernatizi offer the following clarification: "one reason why the SMarT plan works so well is that inertia is so powerful... The SMarT plan takes precisely the same behavioral tendency that induces people to postpone saving indefinitely (i.e. procrastination and inertia) and puts it to use."[119]

It is worth noting that the SMarT program is even less paternalistic than the automatic enrollment default change studied by Choi, et al. Soft paternalists would likely have no objection to, and would be interested to see the results of, a variation of the SMarT program that includes an automatic enrollment so long as an

[118] *Id., p. S185*
[119] *Id.*

easy opt-out mechanism is also available.

Section 4:

Translation to the Regulation of Cigarettes

The concepts of self-control and time inconsistency problems seem to translate remarkably well to the market for cigarettes.

The traditional economics approach to addictive activities, such as smoking, is called the rational addict model. This model, popularized by Becker and Murphy, asserts that "consumption of addictive bads is governed by the same decisionmaking process as is consumption for all other goods. Consumers trade off utility gains from consuming the good against the costs of doing so, and as rational forward-looking agents they recognize that those costs include the damage that they are doing to themselves through consumption, as well as the additional future damage to which they are driving themselves by consuming more of an addictive good. In this standard revealed preference framework, there is no rationale for government regulation of addictive bads other than interpersonal externalities," since, "individuals are pursuing these activities "rationally."[120]

There is, however, an increasingly established body of evidence suggesting that self control and time inconsistency problems play a significant role in the consumption of addictive goods such as cigarettes.

[120] Gruber, Jonathon and Boton Koszegi, "A Theory of Government Regulation of Addictive Bads: Optimal Tax Levels and Tax Incidence for Cigarette Excise Taxation," National Bureau of Economic Research, Working Paper 8777, (2002). Citing, Becker, G., Grossman M. and K. M. Murphy, "An Empirical Analysis of Cigarette Addiction," *American Economic Review,* 84(3), (1994), pp. 393-418.

To begin, as outlined above, there is significant empirical evidence suggesting that individuals are time inconsistent, whereby, "when considering trade-offs between two future moments, present-biased preferences give stronger relative weight to the earlier moment as it gets closer."[121] In other words, there is often an internal struggle of our long-run goals and patient desires against our momentary desires and indulgent selves,[122] and this is more likely the case for short-term pleasures (like smoking), as the social science evidence suggest that time inconsistency is most pervasive in the context of short horizons.[123]

Moreover, econometric tests have established that it is possible to distinguish between time consistent and time inconsistent individuals according to impact on well-being attributable to cigarette taxation. The basis of this model is that while time consistent smokers should be made worse off by cigarettes taxes (in line with the rational addict model of Becker and Murphy), time inconsistent smokers are actually made better off, as taxes provide a mechanism of self-control which these smokers' future selves value.[124]

Relatedly, the frequent use of self-control mechanisms when smokers attempt to quit further bolsters the case for accepting time inconsistency as influential in cigarette addiction, as time-consistent rational actors should have no use for a self-control device whose purpose is to *lower the utility from cigarette consumption.* This is due to the fact that in order for rational, time-consistent actors to decide to quit, they must have first decided that the utility gained from smoking is already too low to justify continued consumption; therefore, self control devices, such as betting with friends or telling acquaintances about the decision to quit would

[121] O'Donoghue, Ted and Matthew Rabin, "Doing It Now or Later," *The American Economic Review,* Vol. 89, No. 1 (Mar. 1999), pp. 103-124.

[122] Beshears, John, Choi, James, Laibson Davin, and Brigitte Madrian, "Early Decisions: A Regulatory Framework," NBER working paper 11920, (2006).

[123] Gruber, Jonathon and Boton Koszegi, "A Theory of Government Regulation of Addictive Bads: Optimal Tax Levels and Tax Incidence for Cigarette Excise Taxation," National Bureau of Economic Research, Working Paper 8777, (2002).

[124] *Id.* Citing, Gruber, J. and S. Mullainathan, "Do Cigarette Taxes Make Smokers Happier?," Mimeo, Massachusetts Institute of Technology, (2001).

serve no purpose.[125]

Finally, smokers exhibit a pronounced incapacity for follow through upon "predicted or desired future levels of smoking"[126] (much like the participants who planned to save more in the Choi, et al, study). For instance, in the case of high school senior smokers, while 56 percent say they will quit within five years, only 31 percent actually do; and of those smoking more than one pack per day, the smoking rate is surprisingly lower amongst those who said they would not quit than those who said that they would.[127] This evidence seems to point towards a conclusion that many people who wish to quit when viewing the decision from afar (rationally) are unable to do so.

Cigarette Regulation: Soft Paternalism Proposals

Given the applicability of self-control, time inconsistency and other problems of bounded rationality to the market for cigarettes, what does soft paternalism have to offer in regards to the regulation of cigarettes? This paper will now outline a few recent proposals below and then follow up with critiques of the proposals and a take upon which proposal is best.

[125] *Id.* Citing, Prochaska, J.O, Crimi, P., Lapsanski, D., Martel, L., and P. Reid, "Self-Change Processes, Self-Efficacy and Self-Concept in Relapse and Maintenance of Cessation and Smoking," *Psychological Reports,* 51, (1982), 983-990.

[126] *Id.*

[127] *Id.* Citing, U.S. Department of Health and Human Services, "Preventing Tobacco Use Among Young People: A Report of the Surgeon General," National Center for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health, (1994).

Proposal 1: Taxation

Perhaps the most common proposal for regulating cigarettes through a regime that attempts to debias, or account for the bounded rationality of, individuals is through increased excise taxation.

The traditional economics approach to the taxation of addictive goods is that government should only step in with taxes or other regulations when externalities arise from the use of an addictive good: "Since smoking, like all other consumption decisions, is governed by rational choice, the fact that smokers impose enormous costs on themselves [internalities] is irrelevant..."[128] Therefore, the current average levels of cigarette taxation (76 cents per pack[129]) are justified as a mechanism for internalizing within the smoker the true costs of smoking that manifest themselves as externalities through increased group insurance rates and money spent on public medical and other programs.

This traditional model, of course, fails to take in consideration self control and time inconsistency problems. The costs of smokers succumbing to desires of immediate gratification are borne by our future selves and not properly accounted for internally due to the time inconsistency phenomenon described above – an internal externality or internality, if you will. Therefore, according to the model proposed by Gruber and Koszegi, which accounts for costs borne by smokers' future selves, the proper level for taxation on cigarettes easily

[128] *Id.,* p. 4.
[129] *Id.* Citing, Gruber, J., "Tobacco at the Crossroads: The Past and Future of Smoking Regulation in the U.S.," *Journal of Economic Perspectives*, 15(2), (2001), pp. 193-212.

exceeds $1 per pack, far above the current level of 76 cents.[130] Taxes that account for internalities, according to Gruber and Koszegi, provide, "a commitment device that is valued by time inconsistent consumers."[131]

Proposal 2: Restricting Retail Outlets or Times of Sale

Recall our discussion of "present-biased preferences" and the "seven versus eight hours of unpleasant activity" example above ("When considering trade-offs between two future moments, present-biased preferences give stronger relative weight to the earlier moment as it gets closer").[132] The idea behind restricting the locations or times where or when cigarettes can be sold is to force consumers to make decisions ahead of time and thereby help mitigate the effect of present-biased preferences.

These proposals would work by reducing the frequency of smokers being near a vendor that will sell them cigarettes (according to Beshears, et al, there are six cigarette vendors within one block of the Harvard Square subway station[133]). For instance a limited number of vendor licenses could be auctioned off, or otherwise distributed, or cigarettes sales could be banned at gas stations, supermarkets or near any center of public transportation. For a time-based regulation, cigarette sales could be limited to 2 hours per day, say 8am-10am.

[130] *Id.,* p. 35.

[131] *Id.,* p. 34.

[132] O'Donoghue, Ted and Matthew Rabin, "Doing It Now or Later," *The American Economic Review,* Vol. 89, No. 1 (Mar. 1999), pp. 103-124.

[133] Beshears, John, Choi, James, Laibson Davin, and Brigitte Madrian, "Early Decisions: A Regulatory Framework," NBER working paper 11920, (2006).

Such proposals could theoretically work by making it more inconvenient for a smoker trying to quit to satisfy a present-biased momentary desire for gratification.[134] If there were only a few cigarette vendors in a smokers' city, for instance, the smoker would be forced to "partially precommit" to a number of cigarettes, versus being able to walk to any convenience store down the block.[135] The added cost of satisfying impulses to smoke would make it easier for a smoker to resist. Furthermore, time-based restrictions would similarly force smokers to precommit to a quantity of cigarette consumption in advance (favoring our future-thinking selves) and even further restrict one's ability to satisfy a momentary urge to indulge in a cigarette.[136]

A variation of time of sale regulations is based upon building a delay between the moment of purchase and the moment of consumption. For instance, cigarette sales could be limited to mail order. This would, again, limit the ability for a smoker faced with an immediate urge to satisfy a "*transitory* desire" to smoke.[137] According to Beshears, et al, a delay-based system, "would work well for a consumer who was happy to commit not to smoke next week, but could not resist smoking right now."[138]

Proposal 3: Facilitating the Enforcement of Self-Regulation

The facilitation of self-regulation, where the consumer decides whether to restrict smoking decisions and to what extent, offers the benefit of maximizing consumer-autonomy.

Beshears, et al, imagine self-regulation working through one of a variety of ID card mechanisms. For instance,

[134] *Id.*
[135] *Id.*
[136] *Id.* Beshears, et al, note that both location and time restrictions already exist in some forms in the U.S. for both cigarettes and alcohol.
[137] *Id.*
[138] *Id.*

the least restrictive ID card regime would require consumers to hold a cigarette license to buy a pack of cigarettes, which they could obtain by simply filling out an application and paying a modest maintenance fee. A built in delay between filing the application and delivery of the card (say, one month) would help even the playing field between present-biased (driven by indulgent impulses) and future thinking selves, as would the ability to tear up or throw away the card if an individual decides to quit.[139] According to Beshears, et al, an annual expiration date would also provide smokers wanting to quit with a "salient quit date."[140] Importantly, the ID card regime benefits from a default of not smoking, "since *not* applying for the cigarette card is the path of least resistance."[141]

A cigarette ID card regime could also allow for individuals to customize their self-regulation. For instance, consumers could choose from (or not choose any) a host of possible restrictions *ahead of time* to preemptively limit the ability of present-biased impulses to override and impose internality costs upon their future-thinking selves. For instance, restrictions upon a license, such as time of day or location restrictions could be printed on the ID card, or limits on the quantity of cigarette purchases selected could be imbedded into a magnetic strip (i.e. 5 packs per week).[142]

While consumers would, and should, be able to alter their preferences, Beshears, et al, envision a system where adjustments to customized restrictions would be time-delayed (i.e. three days), "preventing consumers from increasing allowances on impulse in order to smoke immediately."[143]

Critiques and Picking a Favorite

[139] *Id.*
[140] *Id.*
[141] *Id.*
[142] *Id.*
[143] *Id.*

To begin, all of the proposed soft paternalism approaches to cigarette regulation are subject to the criticism directed toward paternalism generally. Indeed, all of the approaches outlined above involve measures "with the explicit goal of improving welfare of the people affected by them."[144] We do not address these concerns again here, however, as they have been discussed at length above.

There, are however, further criticisms that are more specific to the use of soft paternalism to combat issues of self-control and time-inconsistency. Glen Whitman, for instance, argues that, "internality theory in its current form unjustifiably 'takes sides' when it chooses to favor some personal interests over others."[145] By "taking sides," Whitman is referring to regulators choosing to favor the future self over the present self, and offers the clever rhetorical question of whether it is really the place of the government to favor long-run obsessed "misers, workaholics, and anorexics," over short-run sympathetic, "obese and... profligate."[146]

Yet, Whitman seems to ignore the growing social science evidence, discussed above, pointing towards the fact that boundedly rational individuals do not fully appreciate nor internalize the costs they are imposing upon themselves, present and future. Notwithstanding staggering numbers of medical problems and deaths, these un-internalized costs seem especially large in the realm of smoking, as demonstrated by the Gruber and Koszegi study (discussed above). Properly motivated soft paternalism, moreover, does not attempt to take the choice of smoking or overeating away from consumers. Rather, it simply attempts to reduce the impact of bounded rationality on decisions that consumers will still make for themselves.

There are, however, serious problems with several of the soft paternalism approaches to regulating cigarettes. To begin, there are serious questions as to whether an excise tax actually qualifies as soft paternalism at

[144]Sunstein, Cass R., and Richard Thaler, "Libertarian Paternalism Is Not an Oxymoron," *University of Chicago Law Review*, 70 U. Chi. L. Rev. 1159 (Fall 2003).

[145]Whitman, Glen, "Against the New Paternalism: Internalities and the Economics of Self-Control," *Cato Institute Policy Analysis,* no. 563, (Feb 2006), pp. 1, 6.

[146]*Id.*

all. While many, if not most consumers suffer from self-control and time inconsistency problems, inevitably, others do not. Those who do not suffer from time-inconsistency, who want to continue smoking indefinitely, would still have the choice to purchase cigarettes. However, there would be no option to avoid the tax. On that dimension, then, there is no opt-out from the paternalistic regulation and the tax fails the burden imposed by soft paternalism.

Moreover, this criticism holds true for the location-based and time-based restrictions (including the delay approach) as well. While happy smokers can still purchase and consume cigarettes under either approach, they would be heavily burdened with no opt-out mechanism and their welfare would suffer as a result. While these measures may, as an empirical matter, still benefit society on a net basis, it would be a strain to consider them true soft paternalism measures.

Taxation suffers from the further flaw that properly calibrating taxes is far from an easy task. To begin, the \$1 plus excise tax proposed by Gruber and Koszegi takes into account internalities and *add* the proper tax attributable to internalities on top of the tax that is assessed to account for externalities (i.e., state funded medical expenses or increased group insurance rates). There is considerable controversy, however, as to the true extent of externalities attributable to cigarette smoking. While some economists assert that the proper taxed based upon externalities is 16 cents, others claim the proper level is 37 cents, and still others claim that externalities are even higher[147].

On the flip side, one prominent Harvard economist, Kip Viscusi, argues that on a net basis, not only do smokers not cause society a net externality cost, smokers actually save society money. He argues that if you examine smokers through their lifetimes and look at the trajectory of medical costs attributable to smoking and then compare that to the trajectory of healthy nonsmokers, it becomes apparent that while smokers

[147] Gruber, Jonathon and Boton Koszegi, "A Theory of Government Regulation of Addictive Bads: Optimal Tax Levels and Tax Incidence for Cigarette Excise Taxation," National Bureau of Economic Research, Working Paper 8777, (2002).

do impose higher levels of costs upon society at any given time, they do so for a shorter period. Thus, according to Viscusi, the net result, when accounting for societal savings as a result of smokers' shorter lives (i.e. nursing home care, social security, retirement pensions) is actually a net gain to society of 27 cents per pack.[148] While labeling smokers' early deaths beneficial may seem unseemly, the point is that the optimal level of taxation is far from clear when basing it on a calculation of the costs caused by cigarette consumption.

And the Winner is...

The concerns involved with excise taxes, location-based regulations and time-based regulations are not the only reasons why a customizable self-regulation regime, such as the ID card system Beshears, et al, propose, makes the most sense.

To begin, as stated above, an ID card system offers autonomy and consumer choice. Even time-inconsistent individuals have the most information about their own preferences; they just need some help to enforce the decisions made before present-biased preferences take their toll on the rational decision making process.

Moreover, as reflected by the concerns mentioned in regards to the alternative proposals, an ID card system provides time-consistent consumers who wish to continue smoking with no restrictions an easy and complete opt-out, albeit with small costs (i.e. filling out paper work or slightly increased prices as a result of the pass-through of modest administrative fees). In line with soft paternalism principles, those who initially restrict themselves and would like to adjust their restrictions should be able to do so under this plan, by filling out a paper or online form, for instance, albeit with an implementation delay (i.e. 3 days) to maintain

[148] Viscusi, Kip, class lecture, "Economics and Regulation of Antitrust," Harvard Law School (Fall 2005).

protection from impulse driven present-biased preferences.

Furthermore, in a manner reminiscent of the SMarT program introduced earlier, the customizable ID card system with self-selected restrictions, such as on the number of packs consumed (i.e. X number of packs per week or month), allows consumers to restrict themselves in a manner that most accurately reflects their individual long-run preferences; the alternatives, on the other hand would have to be calibrated according to average preferences.

Finally, like the automatic 401(k) enrollment default scheme outlined above, any ID card regime would take advantage of the default rule effect, as consumers who do not take the steps necessary to acquire a cigarette license will be unable to legally purchase cigarettes. This might not only help time-inconsistent smokers quit (in the ways describe d above) but may also discourage non-smokers from ever picking up the addictive habit, as the 401(k) automatic enrollment default rule example shows us that individuals often prefer the path of least resistance.

Although, Beshears, et al, identify other concerns involved with an ID card regime, namely the potential for a black market, an ironic countercultural appeal (where smoking becomes more appealing as it is increasingly discouraged) and costs (of opting out and administrative)[149], these concerns apply to any of the soft paternalism alternatives discussed in this section. Moreover, in regards to costs, administrative costs would likely be far greater under a tax or location/time restriction regime and opt-out costs, as mentioned earlier, would be insurmountable under the alternatives.

[149] Beshears, John, Choi, James, Laibson Davin, and Brigitte Madrian, "Early Decisions: A Regulatory Framework," NBER working paper 11920, (2006).

Conclusion

While paternalism has largely been used as a pejorative term in the United States since the country's inception, a growing body of evidence from the fields of economics and psychology is increasingly adding wind to the back of a movement to begin embracing paternalistic regulations in regards to smoking and other realms.

Soft paternalism offers a way to satisfy both the desire to remain skeptical of government and the temptation to take advantage of well-established evidence that people often stray from the traditional assumption of rational behavior and decision-making in fairly predictable ways, by offering policymakers the possibility of crafting regulations and laws aimed towards correcting irrational behavior so long as individuals can easily opt-out if they so choose.

As the example of 401(k) automatic enrollment shows, we can take advantage of people's tendency to take the path of least resistance by crafting default rules (with opt-outs) that are preset at the welfare maximizing option. Moreover, the innovate SMarT program outlined ways to engage individuals to commit to decisions about the future ahead of time, to mitigate the effect of present-biased preferences. Both these examples displayed tremendous outcomes and, therefore, stimulate hope that similarly motivated programs could be equally useful in other areas of concern, such as cigarette smoking.

A self-regulation regime using customizable cigarette ID cards offers the best of what soft paternalism has to offer. The plan is directed towards an activity that is universally accepted as a "bad" and that imposes great costs upon both society and the individual smokers. Smoking offers an example of where behavior and decisions stray from the rational actor model, as smokers display prominent signs of self-control and time-inconsistency problems, leading them to make choices that stray from their *own* personal assessment of what is in their best interest. Moreover, an ID card regime takes advantage of the innovative soft paternalism tools of default rules and individually selected pre-commitments. Finally, an ID card system includes the lynchpin of soft-paternalism, libertarian pleasing opt-outs, by allowing time-consistent smokers who are not smoking due to self-control problems to opt-out of any regulation, allowing them to maximize their own rationally derived personal welfare with minimal inconvenience or added costs.